

RatingsDirect®

Summary:

Watertown, Massachusetts; General Obligation; Note

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Table Of Contents

Rating Action

Credit Opinion

Related Research

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Credit Profile

US\$43.78 mil GO mun purp loan bnds ser 2021 due 04/15/2041

<i>Long Term Rating</i>	AAA/Stable	New
Watertown GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Watertown GO		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Watertown GO mun purp ln of bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Watertown GO BANs		
<i>Short Term Rating</i>	SP-1+	Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'AAA' long term-rating to the Town of Watertown, Mass.' series 2021 general obligation (GO) school bonds totaling \$43.8 million. At the same time, S&P Global Ratings affirmed its 'SP-1+' short-term rating on Watertown's existing bond anticipation notes (BANs) and 'AAA' long-term rating on the town's existing GO debt. The outlook on all long-term ratings is stable.

The short-term BAN rating reflects our criteria for evaluating and rating BANs. In our view, Watertown maintains a very strong capacity to pay principal and interest when the notes come due. In our view, and in accordance with our criteria "Bond Anticipation Note Rating Methodology" (published Aug. 31, 2011), the town maintains a low market risk profile, because it has strong legal authority to issue long-term debt to take out the notes and is a frequent issuer that regularly provides ongoing disclosure to market participants.

The town's full-faith-and-credit GO pledge secures the BANs and bonds, subject to limitations of Proposition 2 1/2. We rate the limited-tax GO debt on par with our view of Watertown's general creditworthiness, since the ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources, which supports our view of the town's overall ability and willingness to pay debt service.

Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, we rate Watertown higher than the sovereign because we believe the town can maintain better credit characteristics than the nation in a stress scenario based on its predominantly locally derived revenue base and our view that pledged revenue supporting bond debt service is at limited risk of negative sovereign intervention. In 2020, local property taxes generated 76% of revenue, which demonstrated a lack of

dependence on central government revenue.

The town intends to use proceeds of the bonds to finance its elementary school construction projects, street and sidewalk improvements, middle school renovations, and the acquisition of a new fire department ambulance.

Credit overview

The rating reflects our view of Watertown's very strong and growing economy, anchored by access to Boston and research institutions in the surrounding area to support the growing life sciences/biomedical sector in the town, and Watertown's continued maintenance of strong budgetary flexibility as evidenced by continued additions to fund balance, including in fiscal 2020, on a draft audit basis. In addition continued improvement in the economic outlook provides stability with the town's fiscal 2021 performance exceeding budgetary expectations, not including additional stimulus funding from the American Rescue Plan Act (ARPA) (for more information, see "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect). Furthermore, the town's policies and procedures continue to enhance our view that management will make the necessary budgetary adjustments to keep reserves at levels we consider strong and maintain balanced operations. Pension and other postemployment benefit (OPEB) costs are contained and the town will likely begin meaningfully contributing toward its OPEB trust fund since the pension system is projected to be fully funded in the near term. While the town does maintain exposure to economically sensitive revenues, the budget primarily consists of property taxes (76% of annual revenues) and recent growth has helped to continue to offset the excise tax declines and continues to contribute to a stable operating profile.

The rating reflects what we view as the following credit characteristics for Watertown:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 35.8% of total governmental fund expenditures and 7.9x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 4.5% of expenditures and net direct debt that is 87.9% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. However, because of strong management conditions and historically consistent positive results, we expect management to make the necessary budgetary adjustments to maintain balanced operations. Furthermore, management doesn't expect any cash flow pressures in the near term as a result of tax collection delays. Absent the implications of the pandemic, we consider Massachusetts' social risks in line with those of the sector. We

also view governance and environmental risks as being in line with our view of the sector as a whole.

Stable Outlook

Downside scenario

We could lower the rating if finances were to deteriorate significantly or the town were to experience budgetary pressure, especially given potential market volatility, leading to a drawdown on reserves.

Credit Opinion

Very strong economy

We consider Watertown's economy very strong. The town, with an estimated population of 35,264, is located in Middlesex County in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 182% of the national level and per capita market value of \$266,515. Overall, the town's market value grew by 3.3% over the past year to \$9.4 billion in 2021. The county unemployment rate was 2.3% in 2019.

Watertown is approximately six miles west of Boston's center. It has direct access to regional employment centers via the Massachusetts Turnpike; U.S. Route 20; and Massachusetts Bay Transportation Authority, which operates commuter rail and bus services throughout the region.

The town is primarily residential with such properties accounting for over 75% of the tax base; however, Watertown maintains a strong mix of residential neighborhoods and retail centers to diversify the tax base. The town has focused on increasing this mix, with economic development projects centered on a new life science and biomedical space, given that there is growth in the industry, and the town's location near Massachusetts Institute of Technology and Harvard. With continued investment in economic development, the town's assessed value continues to improve, with the assessed valuations rising an average of 8.5% per year over the past five years. Watertown continues to see investment in its Arsenal Corridor with Arsenal Mall undergoing construction of a regional entertainment, retail, mixed-used, 424-residential-unit complex called Arsenal Yards. Construction continues as the project moves to Phase B including development of further life sciences/lab space in a former restaurant. Furthermore, Tufts Healthcare, a nonprofit company, announced it is moving to Canton from Watertown and completed the sale of its 500,000-square-foot building to the for-profit life science developer, Spear Capital Group.

With ongoing development, the town noted that employment remains in line with expectations, with no changes to the main employers. In line with neighboring areas, the unemployment rate in the region spiked during the pandemic to a high of 15% in June 2020; however, it has since recovered to 6% as of December 2020. We expect Watertown's local economy to remain very strong in the near term because of the town's stable residential tax base and continued development in the growing life sciences and biomedical industry.

Strong management

We view the town's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Strong management practices remain evident in the town's maintenance of strong budget-making policies and assumptions and regular monitoring of financial performance. Management uses five years of historical data to develop revenue and expenditure forecasts and adjusts for growth swings on a year-to-year basis. Furthermore, management monitors and reviews budget performance weekly and presents budget-to-actual reports quarterly to the town council during the first two quarters and then on a monthly basis during the remainder of the year. Management engages in outyear planning, using both a five-year capital improvement plan it updates annually and a five-year financial plan that identifies revenue and expenditure issues and trends. It also maintains a formal investment management policy and presents investment performance reports quarterly to the council.

The town maintains budgetary guidelines for debt management policy, which sets aside 8% of its operating budget for debt service and capital projects. It has a formal reserve policy to maintain the fund balance at 8%-15% of government expenditures, to which it has adhered historically.

In addition, the town continues to address concerns related to climate change that could directly affect taxable properties. In particular, Watertown formed a Sustainability Committee to begin the process of planning for climate change and resilience and implementing priority projects.

Strong budgetary performance

Watertown's budgetary performance is strong in our opinion. The town had operating surpluses of 5.0% of expenditures in the general fund and of 6.1% across all governmental funds in fiscal 2020.

Fiscal 2020 results include adjustments for one-time capital expenditures paid for with bond proceeds and recurring transfers. Management attributes the positive performance to higher-than-budgeted revenue, including excise taxes, building permit fees, and other local receipts. The draft audited figures indicate that Watertown's performance continued a positive trend from fiscal 2020, with revenues expected to come in about \$1.4 million favorable to budgeted, driven by inspection fees generated during the year. Expenditures are also expected to end favorable to budget, approximately \$3.6 million under budget, driven by hiring pauses implemented during the year in addition slower spending in departments including lower snow and ice expense items due to a warmer winter.

Property taxes account for 76% of revenue, followed by intergovernmental revenue at about 12% and excises at about 3%. In line with state legislation, the town did allow residents to delay payment of the May 1, payment to June 1, to provide some relief; however, collections continue to remain strong at 97% for fiscal 2020, down slightly from the typical 99% collections annually. Local excise taxes were lower compared with fiscal 2019 due in part to fewer hotel stays and lower meal tax collections.

The fiscal 2021 budget was finalized at \$152.2 million or approximately 1.7% higher than fiscal 2020. The main drivers of the increase include strong growth in property tax revenues, resulting from continued growth in assessed valuations during the period. Management remained conservative, with state aid and local receipts revenues adjusting the budget before finalizing by including a 20% decrease in state aid and a 10% decrease in local receipts. With Massachusetts' announcement to maintain state aid level funded from fiscal 2020 levels, the town expects positive variances in the state aid performance in fiscal 2021. Budget-to-actual figures continue to exceed expectations for the year driven by unbudgeted growth in property taxes from the sale of the former Tufts building, along with continued growth in inspection fees, and permit fees. In addition, the town anticipates receiving approximately \$10.5 million in funding

under the ARPA that will be provided in two installments. However, Watertown has remained conservative by not including these funds into the fiscal 2022 budget and is awaiting further guidance on how it can use the funds. Overall, the town's performance is expected to remain stable and we anticipate at least balanced performance for fiscal 2021.

Very strong budgetary flexibility

Watertown's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 27% of operating expenditures, or \$38.4 million.

The town has consistently maintained very strong budgetary flexibility in the past three fiscal years. Management has used reserves to fund capital in the past but is often reimbursed from grants or future bond proceeds. Management indicated that they continue to maintain an undesignated reserve fund typically used for settling contracts that they can tap into if needed, but overall, Watertown does not anticipate drawing down on its fund balance materially over the next year. However, if available reserves were to decline materially and management is unable to replenish them, we could revise our view of budgetary flexibility to strong and, should reserves decline significantly, this could pressure the rating.

Very strong liquidity

In our opinion, Watertown's liquidity is very strong, with total government available cash at 35.8% of total governmental fund expenditures and 7.9x governmental debt service in 2020. In our view, the town has strong access to external liquidity if necessary.

Watertown is a regular market participant that has issued debt frequently over the past several years, including GO bonds. The town does not maintain any variable-rate debt, direct-purchase debt, or other contingent liquidity risks that could pressure its liquidity.

Town investments are subject to commonwealth guidelines. Watertown invests its cash in low-risk assets, including the commonwealth's short-term investment pool (the Massachusetts Municipal Depository Trust), registered money market funds, or short-term certificates of deposit. For these reasons, the town's available cash remains strong and stable. We expect its liquidity profile to remain very strong over the outlook period.

Strong debt and contingent liability profile

In our view, Watertown's debt and contingent liability profile is strong. Total governmental fund debt service is 4.5% of total governmental fund expenditures, and net direct debt is 87.9% of total governmental fund revenue. Overall net debt is low at 1.6% of market value, which is in our view a positive credit factor.

Following this issue, Watertown has about \$146.7 million of total direct debt outstanding, approximately \$801,000 of which is self-supporting enterprise debt and \$6.2 million is in BANs. This issuance will provide additional funding for the town's school construction project.

Pension and other postemployment benefits

- We do not view pension costs as a long-term credit concern due to high funding, manageable liabilities, and overall low costs.
- We expect contribution increases will likely remain affordable due to revenue strength, strong reserves, and conservative budgeting.

At June 30, 2020, Watertown participated in the following pension plans:

- Watertown Contributory Retirement System (WCRS): 93.7% funded, with a \$14.4 million proportionate share of the net pension liability.
- The state-administered Massachusetts Teachers Retirement System (MTRS): 53.95% funded. Watertown does not recognize a liability under MTRS because the commonwealth makes payments on behalf of the town.

Watertown's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 14.4% of total governmental fund expenditures in 2020. Of that amount, 11.8% represented required contributions to pension obligations, and 2.7% represented OPEB payments. The town made its full annual required pension contribution in 2020. The system uses a 7.8% discount rate, which we view as high. The system is expected to be fully funded by fiscal 2022.

We consider Watertown's OPEB liability a long-term credit consideration; however, it will prevent these costs from escalating by showing greater funding discipline. As of June 30, 2020, the OPEB unfunded actuarial accrued liability totaled \$74.2million. The town maintains an OPEB stabilization fund totaling \$9.5 million, and it currently plans to appropriate this money toward the OPEB trust. In addition, Watertown plans to appropriate savings from pension costs, which will decline significantly in 2021 by approximately \$13 million--to pay the added debt service on the school projects, and meaningfully fund its OPEB liability.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2020 Update Of Institutional Framework For U.S. Local Governments

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